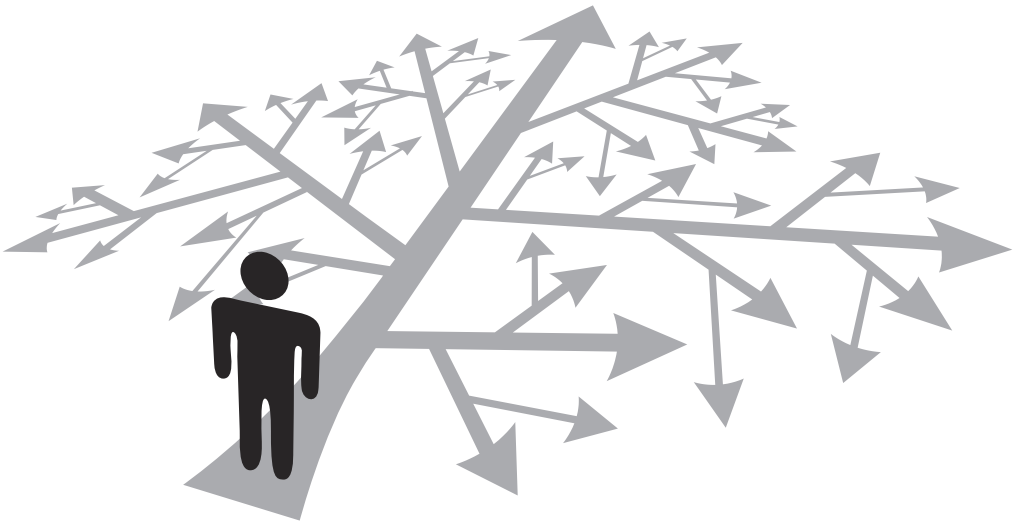
New York Law Journal
A NEW YORK LAW JOURNAL SPECIAL SECTION
Litigation
An ALM Publication
WWW.NYLJ.COM
MONDAY, JANUARY 12, 2015

Traversing the Post-'Halliburton' Landscape

Securities litigators are still searching for the answer.

BY LAWRENCE T. GRESSER AND PATRICK M. CONNORTON



In the months since the U.S. Supreme Court's June 2014 decision in *Halliburton v. Eric P. John Funds,*[1] class action defendants have had no luck when attempting to take advantage of the decision's principal holding. In *Halliburton*, one of the most eagerly (or anxiously) awaited securities decisions in recent memory, the court was asked to overrule *Basic v. Levinson*,[2] a bedrock of securities law for more than 25 years. *Basic* held that investors in securities fraud actions may establish the element of reliance based on the presumption that stock prices reflect all public, material information, including alleged misrepresentations. Although the court declined to overrule *Basic*, it held that defendants in securities class actions should be permitted to rebut the *Basic* presumption at the class certification stage, rather than wait until summary judgment or trial.

The three district courts to consider defendants' attempts to rebut the *Basic* presumption after *Halliburton* have all rejected defendants' arguments, suggesting that defendants are still figuring out how best to utilize the decision.

Section 10(b), 'Basic', and 'Halliburton'

Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5 prohibit material misstatements or omissions in connection with the purchase or sale of a security. To prevail on a claim under §10(b), a plaintiff must show (1) a material misrepresentation or omission by the defendant, (2) scienter, (3) a connection between the misrepresentation or omission and the purchase or sale of a securities, (4) reliance, (5) economic loss, and (6) loss causation.

In *Basic*, the Supreme Court stated that requiring direct proof of reliance posed two problems. First, it would subject plaintiffs to a difficult evidentiary burden in that they would have to show a "speculative state of facts," namely, how they would have acted but for the misrepresentation.[3] Second, it would endanger securities class actions as a whole by requiring individualized inquiries into class members' reliance.

To address these issues, the court drew upon economic theory, specifically, the fraud-on-the-market theory, which posits that, in an efficient market, share prices reflect all publicly available information, including material misrepresentations.

LAWRENCE T. GRESSER *is a partner and* PATRICK M. CONNORTON *is an associate at Cohen & Gresser.*

The court thus held that securities fraud plaintiffs can establish reliance by invoking the presumption that, by virtue of their purchase of a stock trading in an efficient market at a given price, they were relying on any public material misrepresentations. However, the court stressed that "[a]ny showing that severs the link between the alleged misrepresentation and either price received (or paid) by the plaintiff, or his decision to trade at a fair market price" would rebut the presumption of reliance.[4]

In declining to overrule *Basic*, the court in *Halliburton*, with Chief Justice Roberts writing for a 6-3 majority, rejected petitioner Halliburton's argument that *Basic* blindly embraced a view of market efficiency no longer supported by many economists. The court found that Halliburton failed to identify a fundamental shift in economic thinking sufficient to justify overruling a decision that, ultimately, was based "on the fairly modest premise that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices."[5]

Halliburton further argued that *Basic* mistakenly assumed that investments are made in reliance on the integrity of market prices when in fact many investors, such as value investors, make their investment decisions based on the belief that the market price is an inaccurate reflection of the stock's true value. The court responded that *Basic* "never denied the existence of such investors," but concluded that "it is reasonable to presume that most investors … will rely on the security's market price as an unbiased assessment of the security's value in light of all public information."[6]

Halliburton, however, won a consolation prize of sorts. The court agreed that defendants should be afforded the chance to defeat *Basic*'s presumption of reliance at the class certification stage by offering evidence that the misrepresentation did not affect the stock price. Such evidence—e.g., event studies showing how publicly reported events affected stock price—was already admissible at the class certification stage to show that the stock traded in an efficient market, a prerequisite to plaintiff's invoking *Basic*'s presumption of reliance. The court held that it made "no sense" to limit such evidence to this purpose, when such evidence could also show that the misrepresentations at issue had no impact on the stock price, rendering *Basic*'s presumption of reliance inapplicable.[7]

The value of this consolation prize was immediately cast into doubt by Justice Ruth Bader Ginsburg's concurrence. According to Ginsburg, although *Halliburton* will likely broaden the scope of discovery at the certification stage, it will "impose no heavy toll on securities-fraud plaintiffs with tenable claims."[8] The early returns suggest that her prediction is being borne out.

> So far, **neither** the truth-on-the market defense nor evidence concerning the absence of price change **has succeeded.**

'Aranaz'

In *Aranaz v. Catalyst Pharmaceutical Partners*,[9] a district court in the Southern District of Florida rejected as a matter of law defendant's attempt to deploy the so-called truth-on-the-market defense to defeat Basic's presumption of reliance at the class certification stage. *Aranaz* concerned defendant Catalyst's announcement that it had developed the only effective, available drug to treat a rare auto-immune disorder. The day of the announcement, Catalyst's stock price shot up from $1.42 to $2.01. Nearly two months later, a news article reported that another drug treatment for the disorder had been available for years free of charge. In the following days, Catalyst's stock price dropped from $2.61 to $1.52. A putative class of investors subsequently brought suit alleging violations of §10(b) and Rule 10b-5 and sought class certification.

In opposition to the motion for class certification, Catalyst attempted to rebut *Basic*'s presumption of reliance by arguing that the existence of the competing drug was publicly known at the time of Catalysts' announcement. This type of argument is known as a truth-on-the-market defense and requires showing that the matter purportedly misrepresented was already publicly known, meaning the misrepresentation could not have impacted the stock price.

The district court rejected the argument as a matter of law, holding that the truth-on-the-market defense may not be used at the class certification stage because it goes to materiality. The district court reasoned that the defense, "stripped down, is merely an argument that the alleged misrepresentation was immaterial in light of other information on the market."[10] Given the Supreme Court's ruling in *Amgen v. Connecticut Retirement Plans & Trust Funds*[11] that class plaintiffs need not establish materiality at the class certification stage, the district court ruled that, notwithstanding *Halliburton*, the truth-on-the-market defense could not be raised until summary judgment or trial. The district court suggested that finding otherwise would permit defendants to end the controversy on the merits at the certification stage, because a finding that the misrepresentation was objectively immaterial would foreclose all investors' claims. The parties filed a notice of settlement a month after the ruling.

'IBEW Local 98 Pension Fund v. Best Buy'

In *IBEW Local 98 Pension Fund v. Best Buy*,[12] defendant Best Buy was unable to rebut *Basic*'s presumption of reliance with evidence that the stock price was purportedly affected by non-actionable statements rather than the alleged misrepresentations. The case concerned a September 2010 earnings call on which Best Buy representatives stated that the company's earnings were "in line" with its expectations and that it was "on track" to meet certain projections.

Earlier that day, prior to the opening of the market, Best Buy issued a press release reporting that it expected its earnings per share to beat Wall Street expectations. In December 2010, Best Buy reported earnings that fell short of expectations, and its stock price declined 14 percent the following day. A putative class of investors subsequently brought suit alleging that the "in line" and "on track" statements on the earnings call were knowingly false or made with no reasonable basis in fact.

In opposition to plaintiff's motion for class certification, Best Buy argued that a review of the parties' event studies established that the alleged misrepresentations had no price impact. Plaintiffs' event study compared Best Buy's closing price on the day before the conference call with its closing price the day of the conference call. According to Best Buy, this meant that the event study inappropriately reflected the impact of non-actionable statements, namely, the press release Best Buy issued prior to the market's opening the day of the call. Best Buy contended that this press release, rather than the statements made during the conference call, accounted for any purported inflation of Best Buy's stock price.

The court rejected this line of argument as insufficient to rebut *Basic*'s presumption of reliance:

> Even though the stock price may have been inflated prior to the earnings phone conference, the alleged misrepresentations could have further inflated the price, prolonged the inflation of the price, or slowed the rate of fall. This impact on the stock price can support a securities fraud claim.[13]

In effect, the court found that Best Buy failed to prove that the alleged misrepresentation had no impact whatsoever on its stock price and that this was fatal to its attempted rebuttal of *Basic*'s presumption of reliance. The Eighth Circuit has granted Best Buy's petition for interlocutory review of the certification order, and the matter is currently stayed pending appeal.

'Local 703'

In *Local 703, IBT Grocery & Food Employees Welfare Fund v. Regions Financial*,[14] the court rejected defendant Regions' argument that plaintiff's failure to submit an event study on price impact meant plaintiff could not withstand Regions' rebuttal of *Basic*'s presumption of reliance. The case concerned numerous alleged misrepresentations by Regions in 2008 regarding its financial status. In January 2009, Regions made a corrective disclosure, reporting billions of dollars in losses. Its stock price fell nearly 25 percent that day. A putative class of investors brought suit and were certified as a class in a decision predating *Halliburton*. Following an appeal, the Eleventh Circuit remanded the matter to the district court for reconsideration of Regions' price impact evidence in light of *Halliburton*.

On remand, Regions attempted to rebut *Basic*'s presumption of reliance with an event study purporting to establish that the misrepresentations at issue had no price impact. Plaintiff did not submit a countervailing event study, and Regions argued that this doomed their class certification efforts. The court disagreed:

> The defendants read too much into [*Halliburton*]. While that case recognized that an event study can show the reaction of market price to corrective disclosures, nothing in *Halliburton* … requires the plaintiffs to produce an event study in opposition to defendants' event study on a class certification motion.[15]

The court's ruling essentially took the view that, once plaintiff has carried its burden of successfully invoking *Basic*'s presumption of reliance, the burden shifts to defendants to rebut the presumption and plaintiff need not offer further proof of price impact. Regions has petitioned the Eleventh Circuit to grant interlocutory review of the district court's latest order.

Conclusion

Although, under *Halliburton*, securities class action defendants now have an opportunity to rebut *Basic*'s presumption of reliance at the class certification stage, district court decisions to date have not pointed to a clear path to victory for defendants. So far, neither the truth-on-the market defense nor evidence concerning the absence of price change has succeeded. Defendants will of course keep trying to find an approach that works, however. And *Halliburton* itself, which is now back before the district court for consideration of the parties' dueling stock price impact studies, may be a case to watch in this regard.

1. 134 S. Ct. 2398 (2014).
2. 485 U.S. 224 (1988).
3. Id. at 245.
4. Id. at 248.
5. *Halliburton*, 134 S. Ct. at 2410.
6. Id. at 2411.
7. Id. at 2415.
8. Id. at 2417 (Ginsburg, J., concurring). Justice Clarence Thomas similarly predicted that rebutting *Basic*'s presumption at the class certification stage would be "virtually impossible," because such challenges would have to be directed against a class representative whom counsel could handpick from a presumably large pool of investors for the purpose of withstanding the challenge. Id. at 2424 (Thomas, J., concurring).
9. No. 13-CV-23878-UU, 2014 WL 4814352 (S.D. Fla. Sept. 29, 2014).
10. *Aranaz*, 2014 WL 4814352, at *11.
11. 133 S. Ct. 1184 (2013).
12. No. CIV. 11-429 DWF/FLN, 2014 WL 4746195 (D. Minn. Aug. 6, 2014).
13. *Best Buy*, 2014 WL 4746195, at *6. *Aranaz* and *Local 703, IBT Grocery & Food Employees Welfare Fund v. Regions Financial* (discussed infra) also rejected similar arguments. See *Aranaz*, 2014 WL 4814352, at *11-13; *Local 703*, No. CV 10-J-2847-S, 2014 WL 6661918, at *8-9 (N.D. Ala. Nov. 19, 2014).
14. 2014 WL 6661918, at *1.
15. Local 703, 2014 WL 6661918, at *8.